



Statement of the U.S. Chamber of Commerce

ON: Statement on Tax Reform Principles and Priorities

TO: Tax Reform Working Groups

DATE: April 2, 2013

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance -- is represented. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 115 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

INTRODUCTION

Chairman Camp, Ranking Member Levin, Members of the Committee, and tax working group members, the U.S. Chamber of Commerce greatly appreciates the opportunity to comment on how we can reform the tax code.¹

The Chamber appreciates the commitment of the Committee and the working groups to comprehensive tax reform. We applaud the Committee and Chairman Camp for engaging stakeholders through such an open and transparent process. We also understand the challenges presented by this kind of reform but urge the Committee to continue its work to reform the code as soon as possible. Further, as Congress works towards that goal, we strongly urge, that in the interim, no adverse changes should be made to current tax policy.

REVENUE AND SCORING ISSUES

As a cursory matter, the Chamber believes that taxes should be levied for the purpose of obtaining those revenues necessary to fund limited government expenditures in a way that minimizes the negative impact on taxpayers, overall economic growth, and the international competitiveness of American business. Further, Congress should give equal attention to government spending to strike a reasonable balance with a tax code that fosters economic growth, job creation, and investment.

Discussions of tax reform frequently focus on “tax expenditures” contained in the Code. The Chamber believes that these tax expenditures are impossible to define, measure, or aggregate accurately. Revenue estimates of tax expenditures have become such an integral part of the tax policymaking process, however, that how they are conducted is of paramount importance. Thus, as Congress considers comprehensive tax reform, the Chamber urges revenue estimators to take into account likely changes in taxpayer behavior rather than assuming that taxpayers will not take changes in the tax law into consideration.

A recent study² by the nonpartisan Tax Foundation highlights the need for such “dynamic” revenue scoring. While noting that static scoring has “the advantage of simplicity, and it is not too far from the truth for tax changes that either have little impact on incentives at the margin or affect parameters that do not respond much to incentives,” they note that this is an “extremely unrealistic assumption,” particularly in the case of the corporate income tax rate. They further note that:

[c]hanges in that rate do alter rewards at the margin and investors respond strongly to incentives. In other words, when the full economic effects of cutting the corporate

¹ All references to the code are to the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.

² See Schuyler, Tax Foundation, “Growth Dividend from a Lower Corporate Tax Rate,” *available at* <http://taxfoundation.org/article/growth-dividend-lower-corporate-tax-rate>. Note that a majority of the Senate endorsed “dynamic scoring” of changes in tax law during the budget process in 2013. See “The Senate Gets Dynamic,” *Wall Street Journal* (April 1, 2013), *available at* http://online.wsj.com/article/SB10001424127887324685104578386280984564380.html?mod=ITP_opinion_2.

income tax rate are taken into account, the federal treasury would collect more in total revenue than it would lose from the lower rate.

The Chamber agrees that behavioral changes should be considered as comprehensive tax reform is explored and strongly urges Congress to consider the dynamic impacts of tax policies.

COMPREHENSIVE TAX REFORM

The Chamber believes that Congress should undertake comprehensive tax reform – both the individual and corporate tax codes should be reformed simultaneously. The individual and corporate codes are intertwined in such a manner that they must be reformed at the same time.

For example, business tax expenditures included in the code apply to both corporations and pass-through businesses (non-corporate firms such as sole proprietors, S-corporations, limited liability corporations, and partnerships). If corporate tax reform were to take place separately from individual tax reform, and the corporate rate were lowered in exchange for the elimination or reduction of business tax expenditures, pass-through entities would lose the benefit of business tax expenditures without a corresponding rate reduction, thereby harming those businesses.

Likewise, there are many additional interactions between the individual and corporate codes, such as the double taxation of dividends. As such, the Chamber believes that reform must look at both parts of the code simultaneously to ensure consistency across the code and overall pro-growth tax policies.

Additionally, the interrelationship of large businesses, often operating under the C corporation portion of the code, and small businesses, often organized as pass-through entities, is undeniable. According to a September 2010 study,³ the supplier-buyer relationship between American small businesses and large American companies is a basic and entrenched aspect of our economy. Large companies are major customers of small businesses and play a critical role in their growth and success. This once again drives home why we must reform both the individual and corporate codes at the same time.

MARGINAL RATE REDUCTION

Low tax rates promote capital formation and economic growth. Thus, the Chamber believes that tax reform should lower the marginal tax rates to a level that will enable U.S. businesses to compete successfully in the global economy, attract foreign investment to the United States, increase capital for investment, and drive job creation in the United States.

³ See “Mutual Benefits, Shared Growth: Small and Large Companies Working Together,” *available at* http://businessroundtable.org/uploads/studies-reports/downloads/Small_Big_Business_Report_FINAL.pdf. The study concluded that, “[p]arent operations of U.S. multinational companies buy nearly a quarter of all the goods and services they use as inputs in their production from U.S. small businesses – more than an estimated \$1.5 trillion annually; and [e]very \$1 billion in new exports by large U.S. companies would result in approximately \$174 million in new purchases of goods and services from America’s small businesses.”

Corporate Rate Reduction

High Rates and Inaction

Currently, the United States has the highest marginal corporate tax rate among Organisation for Economic Cooperation and Development (“OECD”) countries.⁴ At 35%, the U.S. marginal corporate tax rate is completely out of step with other major industrialized OECD nations. As noted by the Tax Foundation, “studies show that even the *effective* corporate tax rate in the United States is one of the highest in the world.”⁵ Last year, they noted that “2012 mark[ed] the 21st year in which the U.S. corporate tax rate has been above the simple average of OECD nations. Even if we account for country sizes, the weighted average of OECD nations fell below the U.S. rate in 1998 and has been getting lower ever since.”⁶

We not only shackle our businesses with high rates, but we have taken no action to lower our rate as other countries have acted. As the Tax Foundation notes, “there have been 133 major corporate tax cuts globally since 2006. Indeed, between 2006 and 2010 alone, more than 75 countries cut their corporate tax rates - some more than once.” Our major trading partners—Canada and the United Kingdom – have already taken steps to make themselves more competitive by dropping their corporate tax rates, while the United States has done nothing to reduce rates.⁷ Tax reform must address the U.S.’s uncompetitive marginal corporate tax rate.

For example, in Canada, the business tax rate was reduced to 15% on January 1, 2012.⁸ This tax cut was the most recent in a series, first initiated in 2006, that lowered Canada’s federal corporate income-tax rate to less than half of the U.S.’s 35%. This rate cut has resulted in little loss in corporate revenues (when compared with pre-recession revenue levels).⁹ Likewise,

⁴ See Hodge, “The Countdown is Over. We’re #1,” Tax Foundation, *available at* <http://taxfoundation.org/article/countdown-over-were-1>. The United States just recently passed the year mark of holding the number one position. See Becker, “Corporations: America’s had top corporate tax rate for one year,” *TheHill.com* (April 2, 2013), *available at* <http://thehill.com/blogs/on-the-money/domestic-taxes/291157-corporations-americas-had-top-corporate-tax-rate-for-one-year>.

⁵ See Schuyler, Tax Foundation, “Growth Dividend from a Lower Corporate Tax Rate,” *available at* <http://taxfoundation.org/article/growth-dividend-lower-corporate-tax-rate> (emphasis added). They note that across all 13 studies they examined, the U.S. effective corporate tax rate exceeded the foreign average by 7.6 percentage points, if all countries are counted equally. Further, they note that the U.S. effective corporate tax rate “exceeded the foreign average by 3.7 percentage points, if countries are weighted by their gross domestic products (GDP).” Id.

⁶ See Hodge, “The Countdown is Over. We’re #1,” Tax Foundation, *available at* <http://taxfoundation.org/article/countdown-over-were-1>.

⁷ See id.

⁸ See Hodge, “Canada Cuts Corporate Tax Rate to 15%, Lowest Overall Rate in G-7,” Tax Foundation, *available at* <http://taxfoundation.org/blog/canada-cuts-corporate-tax-rate-15-lowest-overall-rate-g-7>.

⁹ See id. Hodge, quoting an article in the *Globe and Mail*, that,

Remarkably, the gradual lowering of the corporate tax rate appears to have resulted in little loss in corporate tax revenue (when compared with long-term, prerecession revenues). Corporate tax revenue did take a big hit (\$10-billion) in 2008, the year of the market meltdown. But the tax cuts were barely started in 2008. By 2010-2011, federal corporate tax revenue reached \$30-billion, substantially more than the average of \$25-billion in the last four years of the prior Liberal government: 2002 through 2005. Further, federal corporate tax revenue equalled (sic) 1.8 per cent of Canadian gross domestic product, a much higher percentage than the revenue produced during the recessionary years in the early 1990s. In tough-times 1992, for example, corporate revenue, with higher tax rates, fell to 1 per cent of GDP.

countries like Japan,¹⁰ which was the only country with a higher corporate tax rate than the United States prior to 2012, and the United Kingdom,¹¹ have also dropped their corporate tax rates.

Foreign Direct Investment (FDI)

Foreign direct investment in the United States is an important part of our economy. According to a March 2013 Organization for International Investment (OFII) report, in 2012, “inbound investment amounted to 11% of all nonresidential domestic investment... and these investments support more than 5 million well-paid insourced jobs.”¹² While the United States is currently a leader in the dollar amount of foreign direct investment, its global share has dropped dramatically in recent years, down from 37% in 2000 to 17% in 2011.¹³ The U.S.’s high corporate tax rate not only affects the ability of American worldwide companies to compete, but also is a factor that can impact decisions by foreign companies to invest in the United States.

Estimates of the responsiveness to corporate tax rates on FDI vary, but a 2008 OECD analysis¹⁴ of the literature finds “an average semi-elasticity value of -3.72 (measuring the percentage change in FDI in response to a 1 percentage point change in the tax rate).” In other words, a one percent increase in a tax rate can result in a decrease in FDI of 3.72%.¹⁵ The OECD study further notes that “studies using more recent data are found to produce larger semi-elasticities, indicating that FDI is becoming more responsive to taxation over time.”¹⁶

While greater competition for global investment and emerging markets play a role in global allocation of investment, the tax sensitivity articulated in the OECD report cannot be ignored. If the United States wishes to retain, or increase, its attractiveness to foreign investment, a lower tax rate is a vital aspect of attracting that investment that can drive job and economic growth.

¹⁰ See Hodge, “The Countdown is Over. We’re #1,” Tax Foundation, *available at* <http://taxfoundation.org/article/countdown-over-were-1>.

¹¹ See “UK announces a further corporate tax rate reduction,” Deloitte, European Tax News Alert (Dec. 10, 2013), *available at* <http://www.pwc.com/us/en/tax-services-multinationals/newsletters/european-tax-newsalert/uk-announces-further-corporate-tax-rate-reduction.jhtml>. Chancellor George Osborne announced in December 2012 a reduction in the main corporate tax rate to 21%, effective April 1, 2014. The U.K. corporate tax rate is already scheduled to decrease to 23% effective April 1, 2013. The United Kingdom “will then have the lowest tax rate of any major western economy.” *Id.* More recently, on March 20, 2013, Chancellor Osborne announced that the United Kingdom will again drop its rate, to 20%, in 2015. See “Osborne says UK corporation tax to fall to 20 percent in 2015,” *available at* <http://www.reuters.com/article/2013/03/20/us-britain-budget-corporation-idUSBRE92J0LV20130320>.

¹² See OFII, “Foreign Direct Investment in the United States 2012 Preliminary Data,” (March 2013), *available at* http://ofii.org/docs/FDIUS_3_20_13_FINAL.pdf.

¹³ See *id.*

¹⁴ See OECD, “Tax Policy Study No. 17: Tax Effects on Foreign Direct Investment: Recent Evidence and Policy Analysis,” Executive Summary, *available at* <http://www1.oecd.org/ctp/tax-policy/39866155.pdf>.

¹⁵ See also Hodge, “Ten Reasons the U.S. Should Move to a Territorial System of Taxing Foreign Earnings,” Tax Foundation, *available at* <http://taxfoundation.org/article/ten-reasons-us-should-move-territorial-system-taxing-foreign-earnings>.

¹⁶ See OECD, “Tax Policy Study No. 17: Tax Effects on Foreign Direct Investment: Recent Evidence and Policy Analysis,” Executive Summary, *available at* <http://www1.oecd.org/ctp/tax-policy/39866155.pdf>.

High Tax Rate and Impact on Labor

Not only are there detrimental competitiveness and investment issues with the U.S.'s high corporate tax rate, studies suggest that higher corporate tax rates mean lower wages. A December 2010 study by Kevin Hassett and Aparna Mathur¹⁷ examined 65 countries over 25 years and concluded that a 1 percent increase in corporate tax rates leads to a 0.5-0.6 percent decrease in wage rates. Likewise, a study by Desai, Foley, and Hines¹⁸ reinforces this finding, concluding that the burden of corporate taxation is borne by labor to a significant degree.¹⁹

Pass-Through Entity Tax Rates

High Rates

As Congress considers lowering the corporate tax rate, it also must address the rate of those businesses that operate as pass-through entities. Like corporations, pass-through entities face nearly the highest rate among industrialized countries on business income. Under the individual code, pass-through entities face a top marginal rate of 39.6%, even higher than the anti-competitive 35% rate faced by C corporations. Their combined marginal rates are close to 45%.²⁰

Pass-Through Footprint

The number of businesses facing these high rates is significant. According to the Tax Foundation, between 1980 and 2008, the total number of pass-through businesses nearly tripled, from roughly 10.9 million to 31.8 million, and more business income is taxed under the individual Code from pass-through businesses than is taxed under the traditional corporate code.²¹

Additionally, a 2011 study²² by Ernst & Young found that more than 90% of businesses in the United States are organized as pass-through entities. That study also found that individual owners of pass-through entities paid 44% of all federal business income taxes between 2004 and 2008 and, moreover, that pass-through businesses employ 54% of the private sector work force

¹⁷ See Hassett and Mathur, "Spatial Tax Competition and Domestic Wages," (December 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2212975&download=yes.

¹⁸ See Desai, Foley, and Hines, "Labor and Capital Shares of the Corporate Tax Burden: International Evidence" (2011).

¹⁹ Even the Tax Policy Center (TPC) now treats 20 percent of the corporate income tax burden as falling on labor. See "How TPC Distributes The Corporate Income Tax," (September 2012), *available at* <http://www.taxpolicycenter.org/UploadedPDF/412651-Tax-Model-Corporate-Tax-Incidence.pdf>.

²⁰ See Dave Camp, Chairman, House Ways and Means Committee, Letter to Paul Ryan, Chairman, House Budget Committee, *available at* http://images.politico.com/global/2013/03/10/fy14_budget_letter_from_wm.html (dated 3/6/13). See also House Budget Committee, FY2014 Budget Resolution, *available at* <http://budget.house.gov/uploadedfiles/fy14budget.pdf>.

²¹ See Hodge and Raut, "Individual Tax Rates Also Impact Business Activity Due to High Number of Pass-Throughs," Tax Foundation, *available at* http://taxfoundation.org/article/individual-tax-rates-also-impact-business-activity-due-high-number-pass-throughs#_ftn3.

²² See Carroll and Prante, "The Flow-Through Business Sector and Tax Reform," *available at* <http://www.s-corp.org/wp-content/uploads/2011/04/Flow-Through-Report-Final-2011-04-08.pdf>.

in the United States.²³ The same Ernst & Young report found that if corporate tax reform is undertaken separately from individual tax reform, the income taxes paid by pass-through entity owners would have increased, on average, by 8%, or \$27 billion annually between 2010 and 2014.²⁴

Entity Choice Considerations

As Congress considers comprehensive tax reform and the appropriate marginal rates for businesses, the Chamber believes it is crucial that consideration be given to why taxpayers choose to operate as pass-through entities.

From a tax perspective, operating as a pass-through entity avoids the double taxation that C corporations face – they are taxed at the corporate level on their profits and many of their shareholders pay tax again when those same earnings are distributed as dividends or when shareholders sell their stock and remit capital gains taxes; conversely, pass-through entities pay no entity level tax and, instead, profits are reported on the individual returns of owners.

From a non-tax perspective, taxpayers choose to operate as pass-through entities for a variety of non-tax reasons. Pass-through entities provide flexibility that the C corporation structure does not allow. For example, partnerships can have one partner put in cash, another put in property, and another expertise. They can then set up their own agreement for how the profits will be divvied up; a C corporation structure does not have that flexibility.

Simplicity is another non-tax reason taxpayers choose a pass-through entity form. To form a partnership all that is needed is two people with a profit motive and an agreement. Conversely, with a C corporation a taxpayer has to file articles of incorporation, elect a board of directors, have regular shareholder and director meetings, etc. Further, pass-through entities make it easier to plan for business succession and ease estate tax planning concerns.

Progressivity Issues

As Congress considers comprehensive tax reform, the Chamber notes that we already have one of the most progressive tax systems when compared with other OECD countries; our higher income earners and successful small businesses already shoulder more than their fair share of the income tax burden.

Our tax burden is already heavily skewed toward higher income earners. A 2012 Congressional Budget Office (CBO) report²⁵ shows that in 2009 the top 1% of households paid almost 23% of ALL federal taxes and the top 20% (“highest quintile”) paid almost 68% of all taxes. Conversely, the middle and lowest quintile paid only 9.4% and 0.3%, respectively. For the bottom quintile, this represents the lowest shares in the CBO’s entire reporting period from 1979 to 2009.

²³ See *id.*

²⁴ See *id.*

²⁵ See CBO, “The Distribution of Household Income and Federal Taxes, 2008 and 2009,” updated August 10, 2012, available at <http://cbo.gov/publication/43373>.

The imbalance in the tax distribution becomes more pronounced when only income taxes are considered. According to IRS Statistics of Income (SOI) data for 2010,²⁶ the top 1% of taxpayers, while earning 19% of income, paid 37% of the total income taxes collected by the federal government. Further, the top 5% of taxpayers, while earning 34% of income, paid about 59% of income taxes in 2010. Conversely, the bottom half of taxpayers earned 12% of all income, but paid only 2.36% of all income taxes. Even this understates the true progressivity of the federal income tax system, since it fails to reflect that many taxpayers in the bottom quintile actually face negative income tax liabilities.

In sum, given the significant and growing number of businesses that operate in pass-through form, the reasons for certain entity elections, and the existing progressivity in our system, the rate of tax these businesses are subject to also must be addressed. Further, there is bipartisan recognition of this need for comprehensive tax reform.²⁷ Accordingly, as Congress considers lowering the tax rate paid by those taxpayers who operate in C corporation structures, it must also address the rates paid by those pass-through entities that remit tax at individual marginal rates.

INTERNATIONAL

It is to the mutual advantage of all countries that the exchange of goods, capital, and services in international trade not be unduly hindered by taxation. Even if other conditions are favorable, excessive taxation by a single country or multiple taxation by two or more countries of the same property or income will destroy the incentives to incur the risks involved in international business.

Pro-growth international tax policies are instrumental to both the ability of American worldwide companies to compete globally and grow not only their global footprint, but also U.S. jobs and operations. Additionally, as noted above, international tax policies must not hinder foreign investment in the United States and the economic and job growth it brings.

²⁶ See IRS SOI, “Number of Returns, Shares of AGI and Total Income Tax, AGI Floor on Percentiles in Current and Constant Dollars, and Average Tax Rates; Classified by: Selected Descending Cumulative Percentiles of Returns Based on Income Size Using the Definition of AGI for Each Year, Table 1, Tax Years: [2001–2010](#).”

²⁷ See “Congress Weighs Small Business Tax Reform,” *Accounting Today* (March 4, 2011), available at <http://www.accountingtoday.com/news/Congress-Weighs-Small-Business-Tax-Reform-57476-1.html?zkPrintable=true> (Congressman Tiberi, Chairman, Way and Means Subcommittee on Select Revenue Measures, noting that “[r]eforming corporate taxes means only reforming roughly 10% of federal revenues... That’s not comprehensive tax reform. Many small businesses pay taxes under the individual income tax rates, as pass-through entities. The last thing we want to do as a part of tax reform is create a situation where we are putting small businesses at a competitive disadvantage.”); Hearing Statement of Senator Max Baucus (D-Mont.) Regarding Changes in the Tax Code since the 1986 Tax Reform Act (March 1, 2011), available at <http://www.finance.senate.gov/imo/media/doc/03012011%20Baucus%20Hearing%20Statement%20on%20Changes%20in%20the%20Tax%20Code%20since%201986%20Reforms.pdf> (Likewise, Senate Finance Committee Chairman Max Baucus has stated, “[w]e receive more revenue from pass-through businesses every year than we do from businesses with traditional corporate structures, called C-corporations. We must consider how efficiently we tax business income, given that so much of it is taxed on an individual basis today.”).

Territorial Tax System

The Chamber believes that the U.S.'s current worldwide tax system, developed more than 50 years ago in an age where global competition was less intense,²⁸ should be replaced with a territorial system for the taxation of foreign source income to help American worldwide companies compete globally and to promote economic growth domestically. A territorial tax system will help allow American worldwide companies to build their global franchises while continuing to strengthen American operations.

In 2013, the United States suffers not only the highest corporate tax rate in the world but is the only major industrialized OECD country that continues to employ a worldwide system of taxation.²⁹ Our high tax rate and possibility of double taxation, while mitigated by provisions such as deferral and the foreign tax credit, harms the ability of American worldwide companies to compete globally.

In recent years, countries seeking to see their domestic companies succeed in global markets have recognized the myriad benefits of territorial systems of taxation. From increased global competitiveness to decreased lockout impacts,³⁰ countries have recognized these benefits and reformed their tax codes accordingly. As a result, the remaining number of countries employing worldwide systems of taxation has decreased from 17 in 2000 to only seven in 2010.³¹

For example, consider Japan. Prior to its adoption of a quasi-territorial tax system, it faced issues similar to those of the United States. The Japanese government was concerned about earnings trapped overseas and the inability of Japanese firms to compete globally.³² Since its international tax reform changes, Japan has seen greater repatriated earnings and its companies holding more globally competitive footing, evidenced through increased acquisitions of foreign companies.³³ Likewise, countries like Germany³⁴ and the United Kingdom³⁵ also have adopted territorial systems to confront competitiveness challenges and compliance concerns.³⁶

²⁸ See Dave Camp, Chairman, House Ways and Means Committee, Letter to Paul Ryan, Chairman, House Budget Committee, available at http://images.politico.com/global/2013/03/10/fy14_budget_letter_from_wm.html (dated 3/6/13).

²⁹ See Dittmer, "A Global Perspective on Territorial Taxation," Tax Foundation, available at <http://taxfoundation.org/article/global-perspective-territorial-taxation>. Chile, Greece, Ireland, Israel, Korea, and Mexico all also employ worldwide but have much smaller economies and lower corporate tax rates.

³⁰ For a complete discussion of the benefits of territorial tax systems, see Hodge, "Ten Reasons the U.S. Should Move to a Territorial System of Taxing Foreign Earnings," Tax Foundation, available at <http://taxfoundation.org/article/ten-reasons-us-should-move-territorial-system-taxing-foreign-earnings>.

³¹ See Dittmer, "A Global Perspective on Territorial Taxation," Tax Foundation, available at <http://taxfoundation.org/article/global-perspective-territorial-taxation>.

³² See "Japan Disproves Fears of Territorial Taxation," Tax Foundation, available at <http://taxfoundation.org/article/japan-disproves-fears-territorial-taxation-0>. See also Ernst & Young, "International Tax Alert: Japan's move to territorial taxation contrasts with US international tax policy," available at <http://tax.uk.ey.com/NR/rdonlyres/edb7ggulansyuajnmmscid3lcobk6ap35suar4geem22gu5bvacg3r52522yugcoujqt mppkniq4qf4zw5sz4zuuayd/ITA077.pdf>; Testimony of Gary M. Thomas, before House Ways & Mean, May 24, 2011, available at <http://waysandmeans.house.gov/uploadedfiles/thomastestimony.pdf>.

³³ See "Japan Disproves Fears of Territorial Taxation," Tax Foundation, available at <http://taxfoundation.org/article/japan-disproves-fears-territorial-taxation-0>. See also "Lessons in Reform—

While the Chamber urges a shift to a territorial system of taxation, we also believe that the details of a territorial system are of the utmost significance. Proper consideration must be given to issues such as the specific exemption system applicable to foreign dividends, the treatment of other foreign income, exceptions to the exemption regime, the use of foreign tax credits for income that continues to be subject to foreign tax levies, the treatment of expenses, and anti-base erosion provisions. These issues are unquestionably complex but must be addressed if the United States wishes to keep pace in the global economy.³⁷

The Chamber notes that should Congress undertake comprehensive tax reform but choose to retain a worldwide system of taxation, provisions that minimize double taxation, such as deferral and foreign tax credits, must be maintained.

Anti-Base Erosion Proposals

Recently, both Chairman Camp's international tax reform proposal³⁸ and discussions by the OECD³⁹ have considered the need for and options on anti-base erosion proposals. The Chamber believes it is important to pay great attention to how these proposals would reduce the competitiveness of American worldwide companies and, further, such proposals should in no way punish the success of these companies. If needed at all, proper time and attention should be spent further developing these alternatives and narrowing their impact so as only to affect the activity intended to be discouraged. Further, careful consideration should be given so that anti-base erosion proposals, like tax reform, do not unfairly penalize or impact any one industry or sector.

The Impact of Territorial Tax Systems on Individuals

As with corporations, the United States has long taxed the foreign-earned income of its citizens residing abroad, resulting in double taxation and disincentivizing the hiring of U.S. citizens. Studies have shown that U.S. expatriates employed as managers in foreign affiliates of

Discussion of Recent Tax Reform in Other Countries," TCPI 11th Annual Tax Policy and Practice Symposium (Statement of Jonathan Stuart-Smith).

³⁴ See Morrison, "Germany Promotes Competition with Shift to Territorial Tax System," Tax Foundation *available at* <http://taxfoundation.org/article/germany-promotes-competition-shift-territorial-tax-system>.

³⁵ See Hodge, "U.K. Strives to have "Most Competitive Tax System Among G20," Tax Foundation, *available at* <http://www.taxfoundation.org/blog/show/27157.html>.

³⁶ See Wilson, "Open for business," *The Sun* (5/20/10), *available at* <http://www.thesun.co.uk/sol/homepage/news/money/2980284/George-Osborne-Corporation-tax-to-be-lowest-in-G20.html>. See also "Lessons in Reform—Discussion of Recent Tax Reform in Other Countries," TCPI 11th Annual Tax Policy and Practice Symposium (Statement of Anneli Collins).

³⁷ See Chamber Written Testimony, Subcommittee on Select Revenue Measures, House Committee on Ways & Means, Hearing on Ways and Means International Tax Reform Discussion Draft, *available at* <http://www.uschamber.com/sites/default/files/111117commentstoWMsonCampint'lPlan.pdf>, for additional detail on international tax reform issues.

³⁸ See Chairman Camp International Tax Reform Proposal, the "Tax Reform Act of 2011," Title III, Subtitle 3, Part 2, *available at* http://waysandmeans.house.gov/uploadedfiles/discussion_draft.pdf.

³⁹ OECD Newsroom, "OECD urges stronger international co-operation on corporate tax," *available at* <http://www.oecd.org/newsroom/oecd-urges-stronger-international-co-operation-on-corporate-tax.htm>.

American worldwide companies are a powerful driver of U.S. exports, so this practice significantly undermines the global competitiveness of U.S. exporters. No other country taxes its citizens working abroad, and the any transition to a territorial tax system should take this into consideration and end this damaging practice.

COST RECOVERY

In General

The Chamber believes that another key aspect of tax reform is cost recovery provisions. Tax reform legislation should eliminate the bias in the current U.S. tax system against capital investment. Capital investment should be expensed or recovered using a capital cost recovery system that provides the present value equivalent to expensing with due regard to the impact the system may have on cash flow.

As the Committee and Congress work towards comprehensive tax reform, the Chamber believes that provisions must be included in the code which allow businesses to more quickly recover their capital investments. Failure to include such provisions, even if coupled with a lower marginal rate, is likely to harm economic growth and job creation.

By way of illustration, the United Kingdom is in the process of reforming its corporate tax regime by gradually reducing the main corporate tax rate from 28% to 20% in 2015. The lower rate is being partly paid for with base broadening, in particular, reducing the allowances for capital costs. Capital allowances for plant and machinery have been phased down from 25% to 18%. Capital allowances on industrial buildings have been phased out to zero.

While the U.K.'s tax system has moved in the right direction in terms of the marginal corporate rate⁴⁰ and its taxation of foreign source income, a recent study by Oxford University's Centre for Business Taxation⁴¹ assessed the current competitiveness of the new U.K. corporate tax system relative to other G-20 countries and OECD countries. Noting that the intent of the United Kingdom in reforming its corporate tax system was "to create the most competitive corporate tax regime in the G20, while protecting manufacturing industries," the study used a methodology developed in the academic literature which considers the effect of corporate taxes on the incentive to invest.⁴²

While the United Kingdom continues to drop its corporate tax rate, it still has a comparatively high effective marginal tax rate relative to OECD countries. According to the

⁴⁰ See "UK announces a further corporate tax rate reduction," Deloitte, European Tax News Alert (Dec. 10, 2013), available at <http://www.pwc.com/us/en/tax-services-multinationals/newsletters/european-tax-newsalert/uk-announces-further-corporate-tax-rate-reduction.jhtml>.

⁴¹ See Bilicka and Devereaux, "CBT Corporate Tax Ranking 2012," Oxford University Centre for Business Taxation, available at <http://www.sbs.ox.ac.uk/centres/tax/Documents/reports/CBT%20Tax%20Ranking%202012.pdf>.

⁴² See id.

study, this ranking is mostly due to the lack of generosity of allowances for capital expenditures: among the OECD countries, only Chile has less generous allowances.⁴³

This study drives home the point that all pieces of a tax system must be pro-growth. Thus, as Congress strives to reform the tax code and create a more pro-growth business environment, the Chamber urges that cost recovery provisions be given appropriate attention.

Research and Development Costs

The Chamber has long advocated that research and development (R&D) expenses should be deductible in the year incurred and a larger credit for increases in research expenditures should be allowed. Further, as other countries expand R&D benefits, the Chamber believes we should consider how the tax code impacts the decision whether to conduct research and development in the United States and, also, where the ensuing intellectual property that is created is located.

Congress first enacted the R&D credit in 1981, finding that “a substantial tax credit for incremental research and experimental expenditures [would] overcome the resistance of many businesses to bear the significant costs of staffing, supplies, and certain computer charges which must be incurred in initiating or expanding research programs.”⁴⁴ Congress has extended the research credit fifteen times since then, most recently in early 2013 as part of tax legislation addressing the “fiscal cliff.”⁴⁵ Legislative history surrounding extension concludes that “[a] research tax credit can help promote investment in research, so that research activities undertaken approach the optimal level for the overall economy.”⁴⁶

While the United States once was a leader in R&D incentives, it has slipped significantly in recent years. A recent study by the Information Technology and Innovation Foundation found that, in 2012, the United States ranked just 27th out of 42 countries studied in terms of R&D incentive generosity, a downward movement from its 23rd ranking of just five years ago.⁴⁷ A February 2012 Deloitte report notes that a significant number of countries now “offer the critical operational prerequisites for successfully conducting effective research and development (R&D),” and, further, are even “promoting relocation of R&D operations as part of their innovation-led economic development strategies.”⁴⁸

The Chamber believes that innovation is a crucial long-term driver of growth and jobs. Any reform to the tax code should contain incentives for companies to conduct research and development activities in the United States and locate the resulting intellectual property within

⁴³ See Bilicka and Devereaux, “CBT Corporate Tax Ranking 2012,” Oxford University Centre for Business Taxation, *available at* <http://www.sbs.ox.ac.uk/centres/tax/Documents/reports/CBT%20Tax%20Ranking%202012.pdf>.

⁴⁴ H.R. Rep. No. 97-201, pt. 1, at 106 (1981).

⁴⁵ Public Law No. 112-240.

⁴⁶ Staff of J. Comm. on Taxation, 104th Cong., General Explanation of Tax Legislation Enacted in the 104th Congress 105 (Comm. Print 1996).

⁴⁷ The Information Technology and Innovation Foundation, “We’re 27th! The United States Lags Far Behind in R&D Tax Incentive Generosity” (July 2012), *available at* <http://www2.itif.org/2012-were-27-b-index-tax.pdf>.

⁴⁸ Deloitte, “2012 Global Survey of R&D Tax Incentives” (February 2012).

U.S. borders.

INVESTMENT

The Chamber has long suggested that investment taxes should be minimized.

Capital Gains

There are detrimental impacts to high capital gains taxes. Currently, individual long term capital gains are taxed at a top rate of 20%. Since the beginning of 2013, capital gains income also has been subjected to the Medicare HI tax, adding another 3.8% tax to the capital gains tax rate. Corporate capital gains rates are even higher, at 35%.

Higher capital gains rates hurt investment. According to the CBO⁴⁹ and studies,⁵⁰ increasing capital gains rates could create a “lock-in effect” where investors avoid higher taxes by not selling assets. If investors are unwilling to sell taxable assets, the lock-in effect can reduce economic growth by preventing the reallocation of capital to more efficient investments. Further, as the CBO notes, “reductions in capital taxation increase the return on investment and therefore the formation of capital. The resulting increase in the capital stock yields greater output and higher incomes throughout much of the economy.”

Further, lower capital gains taxes have significant economic effects on economic growth, jobs and unemployment, inflation, savings, the financial markets, and debt. A 2010 study by Allen Sinai⁵¹ indicates that the net effect of lower capital gains taxation is a significant plus for U.S. macroeconomic performance. The study found that hiking capital gains tax rates would cause significant damage to the economy, reducing growth in real GDP, raising the unemployment rate, and significantly reducing productivity. The study concluded that these losses outweigh any gains in tax receipts from an increased capital gains rate. Further, the study concluded that higher capital gains taxes would not substantially reduce the deficit.

In sum, higher capital gains pose serious risks to the economy. Accordingly, the Chamber strongly urges that any comprehensive tax reform consider the adverse impact higher investment taxes have on investment levels, economic growth, unemployment rates and productivity.

Dividend Taxes

Currently, dividends are taxed at a top rate of 20%. As with capital gains taxes, dividends are also subject to the Medicare HI tax, adding another 3.8% tax to the dividend tax rate.

⁴⁹ See CBO, Capital Gains Taxes and Federal Revenues (October 2002), available at <http://www.cbo.gov/doc.cfm?index=3856&type=0>.

⁵⁰ See Heritage Foundation, Web Memo 1891, Economic Effects of Increasing the Tax Rates on Capital Gains and Dividends, available at http://www.heritage.org/research/reports/2008/04/economic-effects-of-increasing-the-tax-rates-on-capital-gains-and-dividends#_ftn2.

⁵¹ See Sinai, Capital Gains Taxes and the Economy, available at <http://www.accf.org/publications/139/capital-gains-taxes-and-the-economy>.

As with capital gains taxes, there are detrimental impacts to increased dividend taxes. According to the Tax Foundation,⁵² higher dividend tax rates disadvantage the largest dividend-paying companies and reduce the level of dividend paid to shareholders. Further, a September 2010 J.P. Morgan study⁵³ concludes that higher dividend taxes create a disadvantage for dividend-paying companies and may cause companies to alter their current dividend strategies. This could lower the amount of dollars by which companies ordinarily increase their dividends and could reduce the stock value for all shareholders. If this happens, all taxpayers who receive dividend income would be affected by discouraging investment in dividend-paying companies and potentially lowering dividend payouts.

The same J.P. Morgan study⁵⁴ concludes that increased dividend rates could increase economic instability. The study finds that an increase in the dividend tax rate would lead to a higher pre-tax cost of equity. As a result, equity valuation might be under pressure, corporations may reduce their investing due to higher hurdle rates, and debt might become more attractive relative to equity. Further, the study concludes that increasing tax rates on dividends can make investing in stocks less attractive to investors and can reduce a stock's perceived value. This decrease in perceived value coupled with the fact that interest on debt is a deductible corporate expense could cause companies to opt to finance new investments through debt offerings rather than stock issuances. Thus, as a result of this increased incentive to use debt financing, businesses may significantly increase debt levels as they attempt to optimize capital allocation. These increased debt levels could cause greater instability in the economy and increase risk of failure.

As with increased capital gains rates, increasing investment taxes in the form of higher dividend taxes comes with many adverse consequences. Thus, the Chamber strongly urges that investment taxes be kept as low as possible to avoid damaging economic ramifications.

CERTAINTY

The Chamber believes that any reform considered by Congress should address the uncertainty that currently plagues the business community under the current Code, largely due to the temporary nature of so many business tax provisions.

As noted in the National Taxpayer Advocate's 2012 Annual Report to Congress,⁵⁵ there have been approximately 4,680 changes to the tax code since 2001, an average of more than one a day.⁵⁶

⁵² See Tax Foundation, The Economic Effects of the Lower Tax Rate on Dividends, available at <http://www.taxfoundation.org/publications/show/26384.html>.

⁵³ See J.P. Morgan, Unintended Consequences: How higher investor taxes impact corporate finance decisions, available at <http://defendmydividend.com/docs/unintended-consequences-vfinal.pdf>.

⁵⁴ See id.

⁵⁵ See National Taxpayer Advocate, 2012 ANNUAL REPORT TO CONGRESS, available at <http://www.taxpayeradvocate.irs.gov/userfiles/file/Full-Report/Volume-1.pdf>.

⁵⁶ See also Hearing Statement of Senator Max Baucus (D-Mont.), Regarding Changes in the Tax Code since the 1986 Tax Reform Act, available at <http://finance.senate.gov/imo/media/doc/03012011%20Baucus%20Hearing%20Statement%20on%20Changes%20in>

As members of Congress are well aware, the annual exercise by Congress to temporarily extend vital business provisions, such as the research and development (R&D) tax credit, the active financing exception, the controlled foreign corporation (CFC) look-thru rule, and the deduction for state and local sales tax, is an arduous and time-consuming task. The uncertainty surrounding these provisions hinders businesses' ability to most efficiently make decisions, such as those related to hiring employees and making capital investments.

The Chamber therefore urges that changes to the Code as part of comprehensive tax reform be permanent to ensure certainty for businesses striving to expand, create jobs, and remain competitive in the United States and abroad. However, the Chamber also adheres to its longstanding policy that the tax policy process be conducted in an open manner which allows for public comment. Thus, should changes be necessary in the future as a result of findings made during the tax policy process, the Chamber urges Congress to ensure that the tax policy process allows for the implementation of those changes.

COMPLIANCE

The Chamber believes that Congress should enact simple, predictable, and easy to understand tax rules to improve compliance and reduce the cost of tax administration.

As noted in the National Taxpayer Advocate's 2012 Annual Report to Congress,⁵⁷ the code imposes huge compliance burdens on taxpayers. The report notes that the code totals almost 4 million words. As a result of this complexity, taxpayers spend an estimated 6.1 billion hours per year complying with tax filing requirements. In 2010, the estimated compliance cost was \$168 billion. As this report clearly indicates, these compliance costs are unduly burdensome.⁵⁸

The burdens brought by the complexity of our code also harm the global competitiveness of American worldwide companies. Companies must engage in complex tax planning and deal with outdated and inefficient tax provisions simply to compete in the global economy. These

[%20the%20Tax%20Code%20since%201986%20Reforms.pdf](#) (noting that, since 1986, the code has seen over 15,000 changes, and, at the end of 2010, contained 141 temporary provisions which generally require annual renewal by Congress).

⁵⁷ See National Taxpayer Advocate, 2012 ANNUAL REPORT TO CONGRESS, *available at* <http://www.taxpayeradvocate.irs.gov/userfiles/file/Full-Report/Volume-1.pdf>.

⁵⁸ See *id.* The report also notes "individual taxpayers find return preparation so overwhelming that about 59 percent now pay preparers to do it for them. Among unincorporated business taxpayers, the figure rises to about 71 percent. An additional 30 percent of individual taxpayers use tax software to help them prepare their returns, with leading software packages costing \$50 or more. For 2007, IRS researchers estimated that the monetary compliance burden of the median individual taxpayer (as measured by income) was \$258." See *id.* (footnotes omitted). See also Dave Camp, Chairman, House Ways and Means Committee, Letter to Paul Ryan, Chairman, House Budget Committee, *available at* http://images.politico.com/global/2013/03/10/fy14_budget_letter_from_wm.html (dated 3/6/13) (noting burdensome nature of current tax code).

compliance burdens cause valuable resources to be diverted from productive investments to addressing compliance burdens, an inefficient allocation of resources.⁵⁹

Thus, as Congress considers comprehensive tax reform, the Chamber believes such reform should provide simple, predictable, and easy to understand tax rules to improve compliance and reduce the cost of tax administration. By enacting less complex tax rules, Congress could significantly reduce compliance costs and reduce the tax gap without levying new onerous and punitive taxes.

EFFICIENCY

The Chamber is vitally interested in business of all types and sizes, because of the special role each segment of the business system plays in our economy. Thus, the Chamber will not support any tax reform proposal where a specific sector, industry, or income group disproportionately bears the burden of paying for tax reform. Rather, the Chamber believes that comprehensive tax reform should strive to create a code that allows the marketplace, and not the tax system, to allocate capital and resources appropriately.

TRANSITION RULES

The Chamber believes that a critical component of tax reform debate is how to transition to the new tax regime. Thus, tax reform should include transition rules to provide adequate time for implementation of any new system of taxation and to help minimize economic hardships businesses may encounter in moving to a new tax system.

Generally, these transition rules⁶⁰ must give consideration to issues including, but not limited to, treatment of existing deferred tax assets and liabilities, impact on asset valuation, treatment of existing debt, and impact on methods of accounting for existing inventory. In the international arena, consideration must be given to issues such as the treatment of untaxed earnings, the treatment of unused foreign tax credits, and the impact of potential border tax adjustments.

A NOTE ON RETIREMENT ISSUES

The Chamber believes that maintaining current tax incentives for retirement saving is critical. Eliminating or diminishing the current tax treatment of employer-provided retirement plans would jeopardize the retirement security of tens of millions of American workers, impact the role of retirement assets in the capital markets, and create challenges in maintaining the quality of life for future generations of retirees. While we work to enhance the current private retirement system and reduce the deficit, we must not eliminate one of the central foundations –

⁵⁹ See Dave Camp, Chairman, House Ways and Means Committee, Letter to Paul Ryan, Chairman, House Budget Committee, *available at* http://images.politico.com/global/2013/03/10/fy14_budget_letter_from_wm.html (dated 3/6/13).

⁶⁰ For a discussion of transition rule issues in tax reform, see Foster, Tax Foundation, “Principles and Practice of Tax Reform Transition,” Background Paper No. 23, *available at* <http://taxfoundation.org/sites/taxfoundation.org/files/docs/650b130d58b4ed525549effef358a0fc.pdf>.

the tax treatment of retirement savings – upon which today’s successful system is built. Doing so would imperil the existence of employer-sponsored plans and the future retirement security of working Americans.⁶¹

CONCLUSION

The Chamber appreciates the opportunity to comment on comprehensive tax reform. We believe that considerations of scoring issues, tax rates, international issues, compliance burdens, the impact of uncertainty, and transition rules are essential components in the conversation on comprehensive tax reform. We look forward to working with Congress, the Committee, and the working group members as this process continues to make improvements to the code to create a tax environment that is increasingly pro-business and pro-growth.

⁶¹ Additional and more detailed comments on retirement issues in tax reform are being submitted under separate cover.